

## **White Paper: Contribution Methodology & Prepaid Calling Card Industry**

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This white paper attempts to address the options and associated issues/impacts of changes to the USF contribution methodology as related to the Prepaid Calling Card industry. This white paper considers three potential revenue amounts for assessing prepaid calling card revenues – Face Value, Actual (Last) Carrier Revenue and extending contributors to Prepaid LD distributors. This discussion will be useful if the Commission decides to retain an end-user revenue assessment approach, but also if the Commission opts for a “value-added” approach, since one of the main issues with a value added approach is where the value “stops.” This document does not provide a definite direction or preferred option by the author, but does highlight the key industry trends and concerns that will need to be overcome to be fairly implemented. The daunting challenge before the commission is to implement a method that is fair, simple and fosters a level, competitive landscape.

### **Prepaid Industry Trends:**

Historically, the Prepaid Calling Card industry has sold hard cards through extensive retail distribution channels unique to this sector of the telecom industry (See *diagram A*). This has made it difficult for the FCC to apply and enforce rules that were originally created for the direct-to-consumer services for which the telecom industry has traditionally utilized. It is important to understand the Prepaid Calling Card Industry trends to ensure the commission understands the potential impact of future policy. These trends are:

- i) The term “Prepaid Calling Card” and specifically “Card” does not fit the direction the industry is heading. One of the biggest growing trends is toward CARD-less and PIN-less prepaid products where the consumer walks into a store and hands the retailer cash or debit/credit card and the clerk ask for the consumer’s phone number (wireless “MIN” and landline “ANI”). The clerk enters this information into a retail web portal or even text the information to the service provider. After purchase the consumer is either texted an access number or provided one as part of the transaction. The consumer simply dials the access number provided and gets prompted to dial the destination number they wish to call. These solutions have been in the market place for about 6+ years, but are just now taking off due to the high availability and low cost of broadband internet access at even the small independent C-store level. I have already heard from service providers in the industry questioning if these products fall under the current

“Calling Card” USF rules. The better description of this industry today would be the **“Prepaid LD”** industry.

- ii) The above trend also extends into consumer and agent based web portal distribution where the consumer simply provides the phone number of their wireless or landline phone directly via an online consumer based web portal or via a multi-level marketing agent.
- iii) Domestic LD has been significantly impacted by bundled landline and wireless services, resulting in the **Prepaid LD** industry focusing more of its attention on international long distance. Because of the availability of the limited international revenue exemption (LIRE), TRS is now often the biggest portion of required USF-related contributions impacting this industry financially going forward.
- iv) The prepaid wireless and LD industries are starting to merge and it most likely will be hard to distinguish who is providing what to whom in the next couple of years. The **Prepaid LD** industry is already targeting wireless consumers, providing sticky prepaid LD products (i.e. like the ones described in item i & ii above) and at the same time starting to bundling LD packages with wireless SIM cards and selling them online and through retailers. The **Prepaid Wireless** industry is already packaging more aggressive “unlimited” and prepaid LD products and selling them through the larger retail chains, dealers and branded stores. Both of these industries will have the same type of issues and the commission may want to consider addressing them as one.

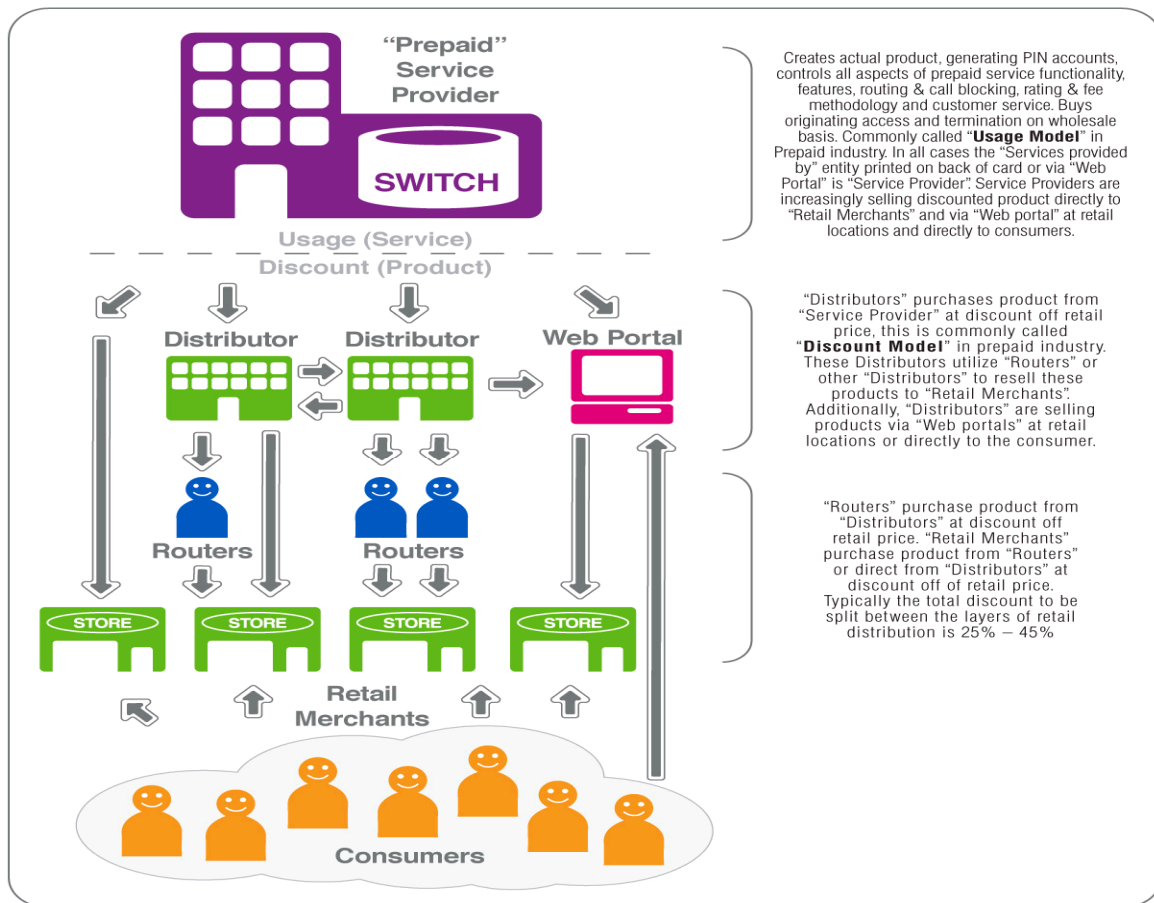


Diagram A

## **Contribution Method:**

- 1) **Face Value** – This is the FCC’s current assessable revenue base method for calculating USF contributions . Although this method works for most telecom products sold directly to consumers, it does not work for products sold through traditional retail distribution (i.e. same as candy bars, soda, bread. etc...). Traditionally in the prepaid calling card industry, most cards are first sold to distributors, who often paid 55-75% of the face value to the carrier. The remaining 25-45% is split between the retailer and all the other layers of distribution required to get product in the market place. The prepaid service providers often do not know how much the cards are sold for at retail. This method also does not fit into traditional GAAP accounting rules because such rules do not permit entities to book revenue that they neither received nor have a reasonable expectation of receiving in the future.

- a. With the trend toward “minute only” or “unlimited” calling cards in large and small retailers, it makes it very difficult to determine the actual “face Value” sold or offered to the consumer. Take for example a current 800 domestic minute calling card sold in a large retailer nationwide. The retailer purchases it directly from a Service Provider for \$18.00 and retails in its stores for amounts ranging \$20 - \$30, with specific regions setting their own retail prices weekly or monthly. This same trend is now showing up in “Unlimited cards” were a small retailer is sold these products for a set price and then resells it to its consumers for whatever price point they prefer.
- b. As some of the large carriers have already indicated, large retailers can contractually and technologically adapt to report actual sold prices of these products. However, for small independent C-Stores it would be financially impossible to implement the same automated systems. If the commission keeps the “face value” requirement, it would hand the large carriers and retailers a competitive advantage over the small independent C-Stores.
- c. The trend toward CARD-less and PIN-Less products (described in item i & ii) could experience the same type of problems as (a & b) above. Ultimately the retailer makes the final decision on how much to charge the consumer via a retail portal, only paying the wholesale amount to the distributor.



- 2) **Actual (Last) Carrier Revenue** - This method would utilize as the assessable revenue base only those revenues that the last telecommunication carrier actually received from selling prepaid LD products -- not the ultimate retail price of those products when they are resold to non-carrier distributors and retailers.
  - a. This approach assesses only the *actual* revenues of telecommunications providers under the Commission’s clear jurisdiction. This would resolve long-standing practical and legal issues.
  - b. This approach has been disfavored because it creates a perception that some end-user revenue is escaping assessment. It is important to recognize, however, that any such revenue is not being received by any telecommunications provider that is subject to the Commission’s jurisdiction. In addition, this concern

undermines the consumer benefits that flow from making prepaid calling cards readily accessible to consumers at familiar retail locations. Attempting to reach revenues beyond the carrier level effectively penalizes producers of prepaid products that attempt to sell through retail distribution chains.

- c. While this approach has many benefits, it also creates certain risks. Service providers could create a loop hole by creating a non-regulated entity where they sell the prepaid calling cards at an unprofitable or breakeven rate, basically deferring any profit to the non-regulated entity and minimizing their contribution base.
- d. In theory this method could also create a disparity and competitive disadvantage between carriers who sell direct to retailers or its own retail locations versus those who sell through multiple distributors. In reality, however, carriers' revenue is typically the same whether the carrier is selling into a multi-step distribution chain or directly to a retailer. The large retailers that buy prepaid products directly from carriers generally sell such products to consumers for lower prices (or make larger profits on selling such products than smaller retailers). In contrast, carriers selling prepaid products directly to their own retail locations, are a very small segment (less than 1%) of the overall industry, but could result in the "loop hole" concerns discussed in item (a) above.

3) **Prepaid LD distributors** - Extending reporting and contributing down to prepaid LD distributors and routers will get you closer to face-value revenue and on the surface seems like a potential option (*see diagram A*). Unfortunately for the reasons below, our experience and observations indicate it would be a compliance disaster for the following reasons:

- a. These levels of the distribution chain are used to selling a product, energy shots, beef jerky, candy bars, calling cards, etc... to small independent retailers (C-stores) and managing their business using software programs like QuickBooks. They also trade product with other distributors making it next to impossible to track which specific products they would have to contribute or be exempt on.
- b. If a value added USF system was implemented within this level, I am convinced there would be a lot of under the radar deals to make sure contributions were minimal!
- c. The number of small and sole proprietorship businesses in this space would make compliance and enforcement impractical and would not create a level competitive landscape.

- d. The trend toward CARD-less and PIN-Less products (described in item i & ii) will most likely result in reducing the amount of distribution layers in this sector, but since there are no physical cards and web sites can be changed like the wind, it will be easier for small distributors to remain under the radar and dodge contributing to the system.